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CHAIR

Sharon L. Larkin
206 Kirchner Ct
Annapolis, MD 21401
(202) 512-2680

CHAIR-ELECT

Stuart B. Nibley
1601 K St, NW
Washington, DC 20006
(202) 778-9428

VICE-CHAIR

David G. Ehrhart
PO Box 748, MZ 1237
Fort Worth, TX 76101
(817) 777-1706

SECRETARY

James A. Hughes
3734 N Woodrow St
Arlington, VA 22207
(703) 387-4814

BUDGET AND FINANCE OFFICER

Jeri Kaylene Somers
1800 F St, NW, Ste 600
Washington, DC 20405
(202) 606-8831

SECTION DELEGATES

John S. Pachter
8000 Towers Crescent Dr, Ste 900
Tysons Corner, VA 22182
(703) 847-6260

Mary Ellen Coster Williams
717 Madison Pl, NW, Ste 612
Washington, DC 20005
(202) 357-6660

IMMEDIATE PAST CHAIR

Mark D. Colley
555 Twelfth St, NW, Ste 730
Washington, DC 20004
(202) 942-5720

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Carol N. Park-Conroy
7404 Rippon Rd
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(703) 768-4045

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Washington, DC

SECTION DIRECTOR

Marilyn Neforas
321 N Clark St, M/S 19.1
Chicago, IL 60654
(312) 988-5596

Writer's Address and Telephone

206 Kirchner Ct.
Annapolis, MD 217401
(202) 512-2680

June 30, 2014

VIA EMAIL

Defense Acquisition Regulations System
Attn: Ms. Amy Williams, Deputy Director
Room 3B855, 3060
Defense Pentagon
Washington, DC 20301-3060

**Re: Public Meeting—Detection and Avoidance of Counterfeit Electronic
Parts—Further Implementation, 79 Fed. Reg. 26725 (May 9, 2014)**

Dear Sir or Madam:

On behalf of the Section of Public Contract Law ("Section") of the American Bar Association ("ABA"), I am submitting comments in accordance with the public meeting and commenting opportunity identified in the above-referenced Department of Defense ("DoD") request for comments regarding further implementation of DARS Case 2012-DO55, Counterfeit Parts Detection and Avoidance Final Rule.¹ The Section thanks DoD for its willingness to consider the Section's comments in this form.

The Section consists of attorneys and associated professionals in private practice, industry, and government service. The Section's governing Council and substantive committees contain members representing these three segments to ensure that all points of view are considered. By presenting their consensus view, the Section seeks to improve the process of public contracting for needed supplies, services, and public works.² The Section is authorized to submit comments on acquisition regulations under special authority granted by the ABA's Board of Governors. The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the ABA and, therefore, should not be construed as representing the policy of the ABA.³

¹ http://www.acq.osd.mil/dpap/dars/docs/fr_2014-10680.pdf.

² Mary Ellen Coster Williams, Section Delegate to the ABA House of Delegates, Jeri K. Somers, Budget and Finance Officer, and Candida Steel and Anthony Palladino, members of the Section's Council, did not participate in the Section's consideration of these comments and abstained from the voting to approve and send this letter.

³ This letter is available in pdf format under the topic Acquisition Reform and Emerging Issues at: <http://apps.americanbar.org/contract/federal/regscmm/home.html>.

I. Introduction

On May 9, 2014, the DoD provided notice of a public meeting to obtain the views of interested parties regarding further implementation of the requirement for detection and avoidance of counterfeit electronic parts, as required by Section 818 of the National Defense Authorization Act (“NDAA”) for Fiscal Year (“FY”) 2012 and Section 833 of the NDAA for FY 2013. 79 Fed. Reg. 26725. The Section understands that this public meeting and commenting opportunity are part of a larger initiative being undertaken by both the Defense Acquisition Regulation (“DAR”) Council and Federal Acquisition Regulation (“FAR”) Council to implement the requirements of the FY 2012 and FY 2013 NDAA regarding the detection and avoidance of the introduction of counterfeit electronic parts into DoD’s supply chain.

II. Public Comment and Coordination Between Rulemaking Councils is Beneficial to the Entire Procurement Community

The Section appreciates DoD’s willingness to engage stakeholders in a collaborative rulemaking process, such as through public meetings and notice and comment opportunities regarding the implementation of this complex set of regulations. The Section believes such an approach will lead to a successful implementation and commends DoD for its outreach. The Section supports DoD’s activities in this regard and looks forward to a continuing dialogue. We urge the DAR and FAR Councils to continue to provide notice as well as to engage in opportunities to seek and consider comments from the public and stakeholder communities in important rulemaking efforts.

The Government and its procurement community share a mutual interest in detecting and avoiding the use of counterfeit electronic parts in the supply chain. A robust dialogue between Government and the public prior to the issuance of rules is especially warranted in the case of rulemaking to detect, avoid and report on counterfeit electronic parts given the potential impact on costs (both to Government and industry) and access to the marketplace. Effective rulemaking sufficiently informs the government procurement community stakeholders – Government, industry, and the public – of the rules, enforcement mechanisms, flow-down requirements, and processes that will be implemented to ensure fair treatment across various types of bidders, contractors, subcontractors, and suppliers. This approach not only provides stakeholders with the opportunity to provide input; it also informs rule-makers of areas of tension between the statutes and implementing regulations, as well as mechanisms to avoid, address or ameliorate these concerns and advance an effective and workable regulatory framework.

It is particularly important to seek public comment in a coordinated effort because, as was explained in the final rule, the DAR Council’s proposed implementation of Section 818 of the NDAA for FY 2012 is through a series of

interrelated regulations, some of which are subject to DAR and FAR cases that have not yet resulted in publication of proposed or final rules for notice and comment.⁴ The Section believes it is important that there be consistency among and between the expanding number of rules that may apply to avoidance, detection and reporting of counterfeit parts to ensure their effective implementation. We strongly recommend that the Councils consider the interactions of these sets of rules and provide appropriate opportunity for notice and comment to ensure that the final result is a cohesive set of rules that meets the Government's legislative and regulatory goals without imposing conflicting or contradictory requirements on industry.

III. Clarification and Flexibility of Flow Down Requirements Would Improve Implementation

As noted below, the Section believes there are some areas in the Final Rule that would benefit from clarification in its further implementation so that the Rule's scope is clear and flexible enough to enable compliance by its various stakeholders:

A. Coverage

The final rule states that its applicability is limited to Cost Accounting Standard ("CAS")-covered prime contractors. The Section believes this reference in the prefatory language and the reference in the rule itself to "CAS-covered contractors" should be revised to reflect that the rule applies to CAS-covered "contracts" and not CAS-covered "contractors." This is what we believe the Rule means and have treated references to this provision in that manner in this set of Comments. The Section urges the Council to adopt our interpretation of these references.

B. Flowdown

DFARS 252.246-7007(e) states that the prime contractor "shall include the substance of this clause, including paragraphs (a) through (e), in subcontracts." It is not clear what precisely is meant by the term "the substance of this clause." That is, are higher-tier contractors afforded flexibility to fashion their own clauses for subcontractors that approximate "the substance of" DFARS 252.246-7007(e), or are they required to flow down paragraphs (a) through (e) of the clause verbatim? The Section encourages the drafters to clarify that contractors are afforded flexibility in tailoring flowdown provisions as may be necessary to meet the objectives of the rule while managing their business risks vis-à-vis each other. We believe that the provision should be clarified to confirm that flexibility exists to tailor the flowdown provisions contemplated by the final rule.

⁴ See, e.g., FAR Case 2013-002 Expanded Reporting of Nonconforming Parts, Proposed Rule, 79 Fed. Reg. 33164 (June 10, 2014).

Another area requiring clarification concerns DFARS 252.246-7007(e), which states that the prime contractor “shall” flowdown the substance of the clause, and DFARS 252.244-7001(c)(19), which requires that subcontracts include flowdown clauses, including the requirements of DFARS 252.246-7007, “if applicable.” The reference to “shall” in one provision and “if applicable” in another creates an ambiguity as to what must be flowed down to subcontractors. The Section believes that clarification of the flowdown requirements would be beneficial to the contracting community.

IV. The Rule Would Benefit From Clarification of Applicability to Sources Other than the Original Manufacturer and Those Authorized by the Original Manufacturer.

As the Senate and Government Accountability Office (“GAO”) investigatory reports make clear, many counterfeit electronic parts enter the defense supply chain when the Government and its contractors need to obtain out of production parts to maintain existing defense systems and to build new systems based on existing plans and specifications. In certain circumstances, the Government and contractor community must move forward with the parts that they have or can obtain to meet their requirements.

The final rule contains provisions that appear to focus on purchasing electronic parts from the prime contractor community and on primary sources of supply such as the original manufacturer or sources expressly authorized by the original manufacturer. It is not clear, for example, whether purchasing parts from suppliers *other than* the original manufacturer or its authorized source is permitted by the final rule only if parts are “not available” from these sources or if contractors can take these other suppliers into consideration when making all purchasing decisions. *See, e.g.*, DFARS 252.246-7007(c)(5).

In contrast to the language in the final rule, the applicable legislation contemplates the use of original manufacturer or authorized sources “whenever possible,” which provides some discretion to the contractor to purchase from other than the original manufacturer or its authorized sources when the parts may be available but, for some reason, it is not possible for the contractor or lower tier subcontractor to purchase from the original manufacturer or authorized source. The Section urges the Council to adopt the same language as is included in the statute.

In addition, when parts are from other than the original manufacturer or authorized source, the final rule requires that such suppliers “meet applicable counterfeit detection and avoidance system criteria.” DFARS 252.246-7007(c)(5). Because the rule is unclear as to what will constitute meeting the acceptable system criteria (or how this will be measured), the Section believes the Council should discuss with the public acceptable standards for purchasing and using parts from suppliers other than original manufacturers or authorized sources when appropriate. Such exchanges

then should be the basis for guidance to both Government and industry regarding the acceptable standards to be followed for DoD programs.

V. Traceability Requirements Should Include Waiver Provisions for Items Where Traceability Documentation Does Not Exist

The final rule requires contractors to establish a traceability process for electronic parts that “shall include certification and traceability documentation developed by manufacturers in accordance with Government and industry standards; clear identification of the name and location of supply chain intermediaries from the manufacturer to the direct source of the product for the seller; and where available, the manufacturer’s batch identification for the electronic part(s), such as date codes, lot codes or serial numbers.” DFARS 252.246-7007(c)(4). Yet such traceability documentation simply does not exist for many electronic parts already in the defense supply chain – including some electronic parts in contractors’ existing inventories. Such required traceability information may be particularly elusive for obsolete electronic parts. Public comment on the proposed rule pointed out that DoD still purchases many electronic parts that are out of production or otherwise unavailable from the original manufacturer or its authorized resellers.

The final rule does not address the potential for waiver of the new DFARS requirements when this issue arises. Thus, the Section recommends that DoD consider adopting rules permitting the following approaches to address such issues:

- Authorizing the Government to purchase parts and provide them to contractors as Government Furnished Property (“GFP”) in situations where the contractor cannot obtain them without a waiver.
- Defining alternative approaches for sources of supply if the original manufacturer or source authorized by the original manufacturer will not agree to the terms of DFARS 252.246-7007(a)-(e).
- Approving a request for termination for convenience when it becomes clear that the contractor cannot acquire necessary electronic parts from a supplier that will accept the terms of DFARS 252.246-7007(a)-(e).

VI. GIDEP Reporting Obligations Remain Problematic

DFARS 252.246-7007(c)(6) requires contractors to report to the Government-Industry Data Exchange Program (GIDEP). However, suppliers outside of Canada and the United States do not have access to GIDEP. In light of this access difference, the Section urges DoD to clarify whether the GIDEP reporting clause may be tailored to address flowdown requirements for these entities. For example, a prime contractor could tailor the clause to require subcontractors that are not or cannot be participants in GIDEP to report to the prime contractor when they become aware of, or have reason to

suspect, counterfeit electronic parts concerns and to authorize the prime contractor to report such instances to GIDEP. The Section believes that it is logical to read the rule as allowing this kind of tailoring to ensure that the rule can be implemented in a workable fashion.

VII. Responsibility for Monitoring Compliance Should be Clarified

Under the final rule, the prime is required to flow down “all counterfeit detection and avoidance requirements” to its lower tier subcontractors. 79 Fed. Reg. 26098. While the rule provides that contractors can apply flexibility in implementation, it is clear from the rule that each prime contractor must come up with a system which includes supervising its subcontractors to some extent. However, specific requirements of such a system are not identified. Unless addressed by the DoD, there is the possibility that contractor systems and subcontractor supervision will be divergent across the spectrum of DoD contractors. The Section recognizes that the DoD may be aware of the vast spectrum of modes of compliance and that this is precisely why the Council has not clearly addressed what is needed.

However, if DoD, as has been announced, intends to superimpose a set of audit and review criteria (in addition to those provided in industry standards), those requirements should be part of the rulemaking process rather than implemented on an ad hoc basis during business system reviews.⁵ Identifying the possible mechanisms and considering what is feasible are complicated issues that must be addressed. These issues are significant for contractors that may have hundreds of subcontractors in their major system contracts and subcontracts. They also present significant issues for lower-tier contractors, because although prime contractors may evaluate or audit them, they will expect the lower-tier contractors to conduct the necessary evaluations of suppliers beneath them in the supply chain. The inclusion of additional guidance on these points is suggested by the Section.

VIII. The Reporting and Disclosure Requirements Remain Unclear

⁵ The FAR’s rule on contractor code of ethics and business conduct and internal controls does not require contractors to review their subcontractor’s purchasing systems. FAR 52.203-13; FAR 3.1003. These FAR provisions also exempt commercial item contractors and small businesses from a “[b]usiness ethics awareness and compliance program and internal control system” requirements. FAR 52.203-13(c). Under the new DoD rules on counterfeit electronic parts, higher-tier contractors may need to have requirements to review, evaluate and monitor subcontractors that are not subject to CAS, and thus do not have their purchasing systems reviewed by DCMA. Such review, evaluation and monitoring where required by the higher tier contractor should be consistent with industry standards given that DoD has not determined a need for review of these subcontractor purchasing systems by DCMA. This is important not only to establish what the higher tier contractor responsibilities are, but to assure that in accordance with the safe harbor provisions of the final rule, there is an approved system so that the prime contractor and its lower tier subcontractors and suppliers are able to take advantage of the safe harbor in the event a counterfeit part intrusion is detected and the other conditions for the safe harbor are met.

Under the new DFARS rule, a contractor's "acceptable" system for detection and avoidance of counterfeit electronic parts is required to include "risk-based" policies, procedures, and methods to, among other things, identify and quickly determine if a suspect part is counterfeit and to provide for the reporting and quarantining of counterfeit and suspect electronic parts. *See, e.g.*, DFARS 246.870-2(b)(6) and (7); DFARS 252.246-7007(c)(7).

DFARS 252.246-7007(c)(6) simply requires that the contractor report and quarantine counterfeit and suspect electronic parts. Reporting is required to the Contracting Officer and GIDEP when the contractor "becomes aware or has reason to suspect" that "any electronic part, end item, component, part or assembly" contains counterfeit or suspect counterfeit electronic parts.

We believe that there is insufficient guidance provided informing a contractor or supplier as to how it might triage risk-based judgments in establishing and applying "risk-based" policies. Similarly, there is insufficient guidance regarding the types of events or circumstances to account for in making such judgments. It is not clear where on the risk continuum a reportable event would arise, or to whom the report should be made. For example, in light of the DFARS provisions, it is not clear whether and to what extent reporting must be made to the DoD Inspector General's Office.

The Section recommends that the Council provide further clarification of reporting requirements and address the intersection between its reporting requirements and possible Inspector General disclosures.

IX. Purchasing System Review Issues Remain

A number of questions remain regarding how a counterfeit electronic part detection and prevention system will be analyzed when DoD conducts a review of the contractor's purchasing system, including the evaluation of any escape of a counterfeit electronic part or suspect counterfeit electronic part into the supply chain. Even with robust counterfeit electronic parts prevention efforts, there is no way to absolutely ensure that such parts will not escape into the supply chain. Given this uncertainty, a single escape of a counterfeit electronic part or a suspect counterfeit electronic part should not result in the *per se* failure of the system, one potentially triggering withholding.

Additionally, we offer the following comment regarding DCMA's planned issuance of a "Counterfeit Detection and Avoidance System Checklist." Given the significant impact that DCMA review of a contractor's counterfeit detection and avoidance system could have, we urge DoD to allow for a notice and comment period before the issuance and application of any interim or final checklist. A checklist developed internally by DCMA without industry input may prove to be unworkable. This checklist likely will drive how contractors develop and shape their systems, and the costs of these systems. Hence, the opportunity for notice, comment and interaction with industry and the consideration of alternative approaches is vital. This process will

also help ensure that different components within DoD can proceed in a coordinated fashion.

The Section urges DoD to participate in notice and comment on what DCMA proposes in terms of an audit program and review criteria for counterfeit part detection and avoidance systems to ensure it is workable. Given the potential cost, resources and impact on timely delivery of needed DoD suppliers, it also is important to clarify the potential liability associated with supplying electronic parts purchased under a contractor's existing purchasing systems.

X. The Allowable Cost Safe Harbor Parameters Are Not Clearly Defined

Given that the final rule went into effect immediately, DCMA does not have a standard for auditing in place yet, and it will take time to audit contractor systems for compliance with the new DoD requirements. This raises a number of questions for the rule's allowable cost safe harbor provision, such as: If a contractor has an approved purchasing system, will this be considered an approved counterfeit part detection and avoidance system until the DCMA conducts its next business system review that specifically addresses the counterfeit part detection and avoidance system? How will DoD and DCMA handle counterfeit part detection and avoidance system reviews of contractors that do not have CAS-covered contracts or subcontracts? If the prime contractor has an approved system, might a lower tier subcontractor that meets the other aspects of the safe harbor, be able to take advantage of the safe harbor? The Section recommends that DoD clarify these issues.

XI. Further Clarification of Definitions and Requirements Would be Beneficial

Revision of the definition of "counterfeit part" and "suspect counterfeit part" to clarify that these terms are limited to electronic parts was an important step in ensuring that the regulations are consistent with the authorizing legislation. Further, the draft definition of "counterfeit electronic part" was improved in the final rule by the inclusion of an element of intent. There remain, however, a few gaps in the definition section of the new rule.

Because the final rule expands the definition of "electronic part" to include embedded software or firmware, it would benefit from further definition of the terms "embedded software" and embedded "firmware." The prior draft that was issued for public notice and comment did not include these terms, which has resulted in a lack of clarity as to DoD's definition of the added terms. The Section recommends that DoD address these terms.

Additionally, the rule is unclear regarding the elements of a counterfeit electronic part detection and avoidance system applicable to embedded software and firmware components. To address these issues, the Section suggests that DoD engage in further collaboration with industry and other government agencies to clarify the

applicable definitions and the counterfeit electronic part detection and avoidance system requirements for embedded software and firmware.

The Section also recommends that DoD clarify the meaning of “current design activity.”⁶ This term should encompass any entity with the legal right to make electronic parts meeting the applicable specifications.

XII. Conclusion

The Section appreciates the opportunity to provide these comments on the proposed rule. The Section is available to provide additional information and assistance as you may require.

Sincerely,

A handwritten signature in dark ink, reading "Sharon L. Larkin". The signature is fluid and cursive, with the first letters of each word being capitalized and prominent.

Sharon L. Larkin
Chair, Section of Public Contract
Law

cc: Stuart B. Nibley
David G. Ehrhart
James A. Hughes
Jeri Kaylene Somers
Council Members, Section of Public Contract Law
Chairs and Vice Chairs, Acquisition Reform and Emerging Issues Committee
and Task Force on Counterfeit Parts
Kara M. Sacilotto
Craig Smith

⁶ It is likely that this concern may be addressed through the pending revisions to FAR Part 46. Until that rulemaking is finalized, however, the lack of definition creates ambiguity in the DFARS rule.